UNITED STATES RAILROAD RETIREMENT BOARD

OFFICE OF INSPECTOR GENERAL

FISCAL YEAR 1999 FINANCIAL STATEMENT AUDIT
REPORT NO. 00-04, FEBRUARY 18, 2000

LETTER TO MANAGEMENT

To the Board Members:

We were engaged to audit the Principal Statements, Related Notes and Supplementary Schedules (hereinafter referred to as "financial statements") of the United States Railroad Retirement Board (RRB) as of and for the year ended September 30, 1999, and have issued our report thereon dated February 18, 2000, in which we rendered a disclaimer of opinion due to the lack of sufficient audit evidence to determine the proper accounting and reporting of the financial interchange receivable and/or payable, and related financing sources.

In planning and performing this audit we considered internal control in order to determine our auditing procedures for the purpose of issuing our report on the financial statements and not to provide assurance on internal control. The maintenance of adequate internal control designed to fulfill control objectives is the responsibility of management. Because of inherent limitations in any system of internal control, errors or irregularities may nevertheless occur and not be detected. Also, controls found to be functioning at a point in time may later be found deficient because of the performance of those responsible for applying them, and there can be no assurance that controls currently in existence will prove to be adequate in the future as changes take place in the organization. However, we noted certain matters involving internal control and its operations that we consider to be reportable conditions under standards established by the Office of Management and Budget (OMB) Bulletin 98-08, "Audit Requirements for Federal Financial Statements," as amended. Reportable conditions are matters coming to our attention that, in our judgment, relate to significant deficiencies in the design or operation of internal control and could adversely affect the RRB's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Our consideration of internal control would not necessarily disclose all matters in internal control that might be reportable conditions.

A material weakness is a reportable condition in which the design or operation of specific internal control does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to the RRB's financial statements may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

In our report on internal control, dated February 18, 2000, we reported a material internal control weakness as a result of our assessment of the RRB's overall control environment and a reportable condition related to the RRB's financial interchange with Social Security and the Healthcare Financing Administration. During our audit we also noted other matters involving RRB's internal control structure and its operation. The details of our findings concerning internal control are presented in the attached summary memorandum. However, neither this letter, nor the attached memorandum, modify our report on the financial statements dated February 18, 2000, referred to in the first paragraph of this report.

Our work was not conducted for the primary purpose of making detailed recommendations about RRB's system of internal control. Had we done so, other matters might have come to our attention that we would have reported to you.

This report is intended solely for the information of the management of the RRB, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties. To the extent that Congress and OMB intend to rely upon this letter and the accompanying memorandum, such reliance should take into account the basis upon which our recommendations were developed, as described above, and the limitations inherent in the internal control structure as described in our report. In addition, Congress and OMB should understand that the criteria used by us in our work could differ significantly from the criteria that they may be using for their purposes.

We wish to express our appreciation for the many courtesies and cooperation extended to us during the audit.

Very truly yours,

Martin J. Dickman
Inspector General

February 18, 2000

MEMORANDUM ON INTERNAL CONTROL

MATERIAL WEAKNESS

Overall Control Environment

The RRB's overall control environment is not adequate to ensure that agency financial statements will be free of material misstatements and prepared in accordance with applicable guidance. As a result, each financial statement audit since FY 1993, has cited the agency for a material weakness in this area.

We believe that the RRB's present administrative structure is the primary cause of this internal control weakness. Management in the agency's various operating components do not seek assistance across organizational lines to resolve problems related to financial accounting and reporting when they arise. As in prior audits, we continue to observe that the RRB's internal control environment is focused on control objectives and techniques designed to meet the organizational responsibilities of each of the individual operating units, rather than the overall objectives of the RRB. As a result, the agency has experienced difficulties in resolving financial accounting and reporting issues that require cross-organizational cooperation.

The RRB is administered by a three member Board appointed by the President, with the advice and consent of the Senate. By law, one member is appointed upon a recommendation made by railroad labor organizations, one upon recommendation of railroad employers and the third member, the Chairman, is to be independent of employees and employers, thereby representing the public interest. The Board members function as chief executive officers (CEO), each one responsible to a different constituency. This structure results in Board members having significant involvement in the operational affairs of the agency. The lack of a single CEO makes it difficult to resolve issues on a timely basis.

Although the agency has undergone extensive reorganization since this weakness was originally cited during Arthur Andersen LLP's audit of the RRB's FY 1993 financial statements, we continue to believe that the lack of a single chief executive impedes the agency's ability to solve problems, including those related to financial management and reporting. We have observed a lack of the pro-active, top-down leadership that is required for the timely resolution of significant financial accounting and reporting problems.

Effective January 1, 1999, the Board established an Executive Committee comprised of the executives responsible for each of the agency's 5 largest organizational units. To-date, this committee has not had a role in resolving problems related to financial statement reporting.

We recommend that the Board assign the responsibility for facilitating cross-organizational cooperation in the design and implementation of internal controls to the Executive Committee. This responsibility should include identification and correction of internal control related problems that cross organizational boundaries **(Recommendation #99-1)**.[1,2]

The RRB did not include our finding concerning the overall control environment as a material weakness in the statements of assurance, issued pursuant to the Federal Managers' Financial Integrity Act, for FYs 1997, 1998 and 1999. Agency management believes that previous reorganization and the establishment of the executive committee have eliminated the material weakness. However, we believe the overall control environment continues to be a material weakness. The conditions that led to the original finding continue to exist and have an adverse effect on the agency's ability to meet its internal control objectives.

REPORTABLE CONDITION

Financial Interchange Estimates[3]

During our audit, we were unable to adequately audit the financial interchange at September 30, 1998. Financial interchange occurs between RRB, the Social Security Administration (SSA) and the Health Care Financing Administration (HCFA). This financial interchange is intended to place the SSA's Old Age, Survivors and Disability Insurance (OASDI) Trust Funds and HCFA's Hospital Insurance (HI) Trust Funds in the same position in which they would have been had railroad employment been covered by the Social Security and Federal Insurance Contribution Acts. The consolidated statement of financial position reflects the estimated net financial interchange transfer from the OASDI and HI Trust Funds in the following amounts:

	1998		1997	
	Principal (billion)	Interest (million)	Principal (billion)	Interest (million)
Transfer From/To				
SSA to RRB	$ 3.519	$ 145.6	$ 3.520	$ 157.6
RRB to HCFA	(.393)	(18.4)	(.385)	(18.7)
Net Financial Interchange Receivable at Year-End	$ 3.126	$127.2	$ 3.135	$138.9

[1] The first two digits of the recommendation number indicate the fiscal year under examination when the recommendation was first made. Unless otherwise indicated, the presentation has not been updated.
[2] This finding has been updated as a result of the FY 1999 audit of the agency's financial statements.
[3] *Letter to Management*, Office of the Inspector General, Railroad Retirement Board, March 5, 1999, page 3. The full text of the original recommendation is reproduced here. All references to "we" and "our" refer to the Office of Inspector General.

The figures presented in the financial statements include estimates of amounts due but unpaid at the end of each fiscal year as well as estimated interest accrued through the end of each fiscal year. Actual determination and settlement of the amounts due at the end of the fiscal year will be made in June of the following fiscal year. The receivable amounts are classified as "Accounts Receivable – Intragovernmental" and "Interest Receivable – Intragovernmental," respectively, and the payable amounts are classified as "Accounts Payable – Intragovernmental" and "Interest Payable – Intragovernmental", respectively. Computation of the accruals involves extensive estimation which, in prior years, has resulted in significant differences between the amounts accrued and the actual settlement. As a result of the extensive estimation and the significance of the resulting differences from actual amounts, we were unable to apply audit procedures to these accruals to determine what adjustments, if any, to the receivable and/or payable and related net revenue amounts might be necessary.

As previously stated, differences between amounts accrued and the actual settlement have had a material impact on the financial statements. Below is a summary of the impact of financial interchange estimates on revenue as reported in the financial statements for fiscal years 1994 through 1997.

IMPACT OF FINANCIAL INTERCHANGE ACCRUAL ACCOUNTING ESTIMATES ON REVENUE

Principal and Interest[4]

Fiscal Year	1997 (millions)	1996 (millions)	1995 (millions)	1994 (millions)
Income Recognized	$ 3,198.6	$ 3,093.0	$ 3,637.3	$ 3,102.2
Less actual Income Realized	(3,249.7)	(3,181.3)	(3,010.2)	(3,565.5)
	=======	=======	=======	=======
Amount over (under)recognized	$ (51.1)	$ (88.3)	$ 627.1	$ (463.3)
Over (Under) Recognized in…				
Prior Year	(75.5)	(163.8)	463.3	0.0
Current Year	24.4	75.5	163.8	(463.3)
	=======	=======	=======	=======
	(51.1)	(88.3)	627.1	(463.3)
TOTAL DIFFERENCE AS A % OF:				
TOTAL REVENUE AND FINANCING SOURCES	-.49%	- .86%	+5.79 %	-4.51%
EXCESS OF REVENUE AND FINANCING SOURCES OVER TOTAL EXPENSES	-8.31%	-15.65%	+53.36%	-63.08%

[4] The figures presented include both principal and interest for the financial interchange accruals related to both the OASDI and Health Insurance trust funds. In FY 1994 there was no over or under recognition related to the prior year because of delays during the first year financial statement audit, the actual settlement amount was included in the financial statements instead of an estimate.

The Bureau of the Actuary prepares the accrual accounting estimates for the financial interchange. These estimates are prepared more than six months prior to the actual settlement date and represent the best available information concerning the future outcome of the interchange calculation prior to the final settlement. The Bureau of the Actuary has stated that no better information is available for inclusion in financial statements unless such statements are published after determination of the final settlement amount.

As a result we have concluded that the financial interchange amounts cannot be reasonably estimated for financial statement purposes. In the present context "a reasonable estimate" is a term of art describing an estimate that will not lead to a material misstatement of the agency's financial statements. While the accrual accounting estimate may be the best available estimate, it is not sufficiently predictive of the final outcome of the financial interchange to be considered "reasonable" for purposes of financial statement reporting.

During the FY 1998 audit, the Office of Inspector General reviewed the pertinent accounting literature and recommended a change in accounting principle to record and report on financial interchange during the year of settlement. The Bureau of Fiscal Operations consulted FASAB for concurrence. FASAB could not, based on the limited discussions that took place, endorse the recommended change.

Based on the lack of availability of "reasonable" accounting estimates, the OIG continues to recommend a change in accounting principle to record and report on financial interchange amounts during the year of settlement (Recommendation #98-1). The OIG acknowledges that the RRB will not be able to implement such a significant change without the concurrence of FASAB and/or the Office of Management and Budget. As result, in order to implement the foregoing recommendation, BFO should develop a full, factual presentation of the accounting, legal and technical issues that underlie the financial interchange process for use in obtaining the necessary concurrence. [5]

[5] This finding has not been updated. Absent a change in the estimation methodology, the results of any single year will not alter the auditor's evaluation. The table on the preceding page is presented as an illustration of past outcomes that have caused auditors to question the accuracy of the financial interchange estimate.

OTHER MATTERS INVOLVING INTERNAL CONTROL

Reconciliation of Payroll Tax Receipts[6]

During our 1995 review, we noted that a reconciliation between the amounts for payroll taxes, paid by the railroads to the IRS, and the amounts credited to the Trust funds accounts, at Treasury, is not being performed. The risk exists that all amounts paid by the railroads are not being deposited into the RRB Trust Fund Account. We recommend that a reconciliation between the amounts shown as payroll taxes paid on each railroad CT-1 and the amounts received and deposited in the Trust Fund Accounts be done on an annual basis. It is our understanding that the RRB has been working with the Department of Treasury and the IRS to develop a system to electronically collect taxes and obtain supporting information to facilitate reconciliation of tax deposits **(Report Recommendation #93-3).**

Automated System for Files' Transfers[7]

During our 1995 review, we noted that there can be delays prior to an application being assigned to an examiner in SIS.[8] The application is mailed from the field office to the Initial Folder Preparation (IFP) section where it [is] matched with the claim folder and finally sent to SIS. Sometimes, there is a delay before the claim folder is received in SIS. An application is not processed until the claim folder is received in SIS. We recommend that an automated system, similar to the Initial Claims (IC) system used in BRB, be developed to efficiently transfer files from the field offices **(Report Recommendation #93-38).**

Backlog of Cases to be Reviewed[9]

During our 1995 review, we noted that a backlog of call-up cases [in what is now the Disability Benefit Division] exists in the post-adjudication section. A disability case is scheduled to be reviewed, or called up, within a prescribed time frame to determine if the recipient continues to meet the eligibility requirements. Various time frames exist based upon the type of disability case. If a case is not reviewed on a timely basis, a risk exists that incorrect benefits will be paid. However, we noted no such instances in our review. We recommend that steps be taken to eliminate the backlog and complete these reviews on a timely basis (**Report Recommendation # 94-1**).

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[6] *Memorandum on Internal Control Structure,* September 30, 1995, Arthur Andersen LLP, page 27. The full text of the original auditors' recommendation is reproduced here. All references to "we" and "our" refer to Arthur Andersen LLP.
[7] *Memorandum on Internal Control Structure,* September 30, 1995, Arthur Andersen LLP, page 29. The full text of the original auditors' recommendation is reproduced here. All references to "we" and "our" refer to Arthur Andersen LLP.
[8] Survivor Initial Section
[9] *Memorandum on Internal Control Structure*, September 30, 1995, Arthur Andersen LLP, page 19. The full text of the original auditors' recommendation is reproduced here. All references to "we" and "our" refer to Arthur Andersen LLP.

Management Control Program Evaluation[10]

In compliance with the Federal Managers Financial Integrity Act (Integrity Act), the Railroad Retirement Board (RRB) has established a management control program. The management control program includes the identification of organizational units ("assessable units") for the purpose of performing internal control assessments. The internal control structure of each assessable unit is evaluated to determine the level of assurance that management is achieving in accomplishing its internal control objectives. The results are reported as a numeric score using a scale from 1(high level of assurance) to 5 (no assurance).

The computer services assessable unit within the Bureau of Information Services (BIS) received a score of "4" which indicates that management "... cannot state that all control objectives are being accomplished."

We recommend that BIS management improve internal controls over computer services to the extent that it can be assessed a rating of at least "2" which is the lowest level at which management can state that "all control objectives are being accomplished" (**Recommendation #97-3**).

Time and Attendance Records

During our testing of payroll records, we noted that time and attendance records are not always retained in accordance with the applicable record retention schedule. In one bureau, six months of timesheets had been discarded by a clerical employee without the prior approval of management. We recommend that BFO remind RRB management and staff of the agency's policy concerning retention of payroll records (Recommendation #99-2).

[10] *Letter to Management*, Office of the Inspector General, Railroad Retirement Board, February 28, 1998, page 4. The full text of the original recommendation is reproduced here. All references to "we" and "our" refer to the Office of Inspector General.

STATUS OF PRIOR AND CURRENT YEAR RECOMMENDATIONS
Recommendations “In Progress” as of 9/30/98 and 9/30/99

We have reviewed the implementation of recommendations resulting from financial statement audits of prior years. A summary of the status of recommendations pending at 9/30/98 and 9/30/99 is presented below.

<table>
<tr><th></th><th>#</th><th>Implemented</th><th>In Progress</th><th>Declined</th></tr>
<tr><td>THE BOARD</td><td></td><td></td><td></td><td></td></tr>
<tr><td>Control Environment</td><td>99-1</td><td></td><td>X</td><td></td></tr>
<tr><td>BUREAU OF FISCAL OPERATIONS</td><td></td><td></td><td></td><td></td></tr>
<tr><td>Reconciliation of Payroll Tax Receipts</td><td>93-3</td><td></td><td>X</td><td></td></tr>
<tr><td>Financial Interchange</td><td>98-1</td><td></td><td>X</td><td></td></tr>
<tr><td>Allowance for Doubtful Accounts</td><td>98-2</td><td>X</td><td></td><td></td></tr>
<tr><td>Time and Attendance Records</td><td>99-2</td><td></td><td>X</td><td></td></tr>
<tr><td>OFFICE OF ADMINISTRATION</td><td></td><td></td><td></td><td></td></tr>
<tr><td>Bureau of Supply and Service</td><td></td><td rowspan="4" colspan="3">Recommendations 95-28, 95-29 and 97-1 have been closed by agreement with the agency. The agency has accepted a more comprehensive recommendation for corrective action presented in OIG audit report #00-01 “Review of Internal control Over Fixed Assets,” dated October 5, 1999.</td></tr>
<tr><td>Fixed Asset Inventory</td><td>95-28</td></tr>
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<tr><td>OFFICE OF PROGRAMS</td><td></td><td></td><td></td><td></td></tr>
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<tr><td>Backlog of Cases to be Reviewed</td><td>94-1</td><td></td><td>X</td><td></td></tr>
<tr><td>BUREAU OF INFORMATION SERVICES</td><td></td><td></td><td></td><td></td></tr>
<tr><td>Management Control Program Evaluation</td><td>97-3</td><td></td><td>X</td><td></td></tr>
<tr><td>ACF2 Logon Usage</td><td>98-3</td><td>X</td><td></td><td></td></tr>
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